

NASD Notice to Members 98-88

Underwriting Compensation In Public Offerings

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ☒ Corporate Finance
- ☐ Executive Representatives
- ☐ Government Securities
- ☐ Institutional
- ☐ Insurance
- ☒ Internal Audit
- ☒ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☐ Registered Representatives
- ☐ Registration
- ☐ Research
- ☒ Syndicate
- ☐ Systems
- ☒ Trading
- ☐ Training
- ☐ Variable Contracts

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) is issuing this *Notice to Members* to remind members that compensation received by members in public offerings of securities is to be determined through negotiation with the issuer offering the securities. Consistent with long-standing policy, it is conduct inconsistent with just and equitable principles of trade for any member or person associated with a member to engage, directly or indirectly, in any conduct that discourages the competitive activities of other member firms. This includes, but is not limited to, directly or indirectly engaging in any conduct that inhibits competition in the pricing of services offered by members including conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence, constrain, or inhibit the freedom of a member or person associated with a member to price its services competitively.

Questions regarding this *Notice* may be directed to Gary Goldsholle, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8104.

Discussion

The National Association of Securities Dealers, Inc. (NASD[®]) Rule 2710(c) prohibits a member or person associated with a member from receiving compensation or participating in a public offering of securities if the underwriting compensation in connection with the public offering is unfair or unreasonable. NASD Regulation's Corporate Financing Department (Department) has direct responsibility for the review of underwriting compensation. The Department reviews public offerings before their effective dates and aggregates all items of value proposed to be received by underwriters and related persons. Total compensation is then

reviewed and a determination is made as to whether the compensation is fair and reasonable.

The pricing of underwriting compensation, including the gross spread on offerings, is determined by the issuer and the underwriter through negotiation, subject to NASD Regulation's review to ensure that it is fair and reasonable. NASD Regulation has noted a high degree of price uniformity in gross spreads charged by underwriters in initial public offerings of corporate equity securities. NASD Regulation considers it important to remind members that there is no standard level of underwriting compensation. Prices should be determined through competition and the level of underwriter compensation on a given transaction should be the product of negotiation between the issuer and the underwriter. The exchange of current price information among competitors in this context may raise serious anti-competitive concerns. Any attempt improperly to influence another member in its pricing is a violation of NASD Rule 2110.

As set forth in IM-2110-5, it is NASD Regulation's long-standing policy that it is conduct inconsistent with just and equitable principles of trade for any member or person associated with a member to coordinate the prices of such member with any other member or associated person; to direct or request another member to alter a price; or to engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another member or person associated with a member. This includes, but is not limited to, any attempt to influence another member or person associated with a member to adjust or maintain a price or other conduct that retaliates against or discourages the competitive activities of another market participant. While IM-2110-

5(5) specifically permits member firms to engage in any underwriting (or any syndicate for the underwriting) of securities to the extent permitted by the federal securities laws, this exclusion does not permit member firms to engage in conduct that discourages the competitive activities of other firms.

Member firms should review their practices and procedures regarding the pricing of their services in public offerings to ensure that such pricing results from appropriate negotiation with the issuer, and that conduct of the type noted above is prohibited. A finding of such conduct will result in disciplinary action. Member firms should also review their supervisory

procedures regarding underwriting compensation to ensure that the requirement for free negotiation of fees is emphasized to all relevant employees and that procedures exist to identify any questionable activity.

© 1998, National Association of Securities Dealers, Inc. (NASD). All rights reserved.